

AMENDED IN ASSEMBLY MAY 8, 2003

AMENDED IN ASSEMBLY MAY 6, 2003

CALIFORNIA LEGISLATURE—2003–04 REGULAR SESSION

**ASSEMBLY BILL**

**No. 1622**

**Introduced by Assembly Member Wyland**

February 21, 2003

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An act to amend Sections 23803, 23806, and 23809 of the Revenue and Taxation Code, relating to taxation, *to take effect immediately, tax levy.*

LEGISLATIVE COUNSEL'S DIGEST

AB 1622, as amended, Wyland. Bank and corporation tax: "S corporation".

The Corporation Tax Law provides that, for taxable years beginning on or after January 1, 2002, corporations that have elected to be taxed as "S corporations" for federal tax purposes are deemed to be "S corporations" for California income tax purposes, unless the entity is prohibited from being a California "S corporation." The Corporation Tax Law, in modified conformity to federal income tax laws, provides for the specified tax treatment of "S corporations" and their shareholders. Among other things, that law requires that an election made under federal income tax laws, relating to certain stock purchases treated as asset acquisitions, be treated as an election for state tax purposes, specifies the application of credits to reduce the entity level tax, and imposes a tax on built-in gains attributable to California sources, as provided.

This bill, for taxable years beginning on or after January 1, 2004, would allow an “S corporation,” as provided, to carry forward a net operating loss incurred by that corporation as a “C corporation” from its last taxable year beginning before January 1, 2002, to the first taxable year beginning on or after January 1, 2004, in which the corporation is treated as an “S corporation” for state tax purposes as a result of the enactment of Chapter 35 of the Statutes of 2002. This bill would also allow an “S corporation” to carry forward the full amount of tax credits generated by that corporation as a “C corporation” to the first taxable year beginning on or after January 1, 2003, in which the corporation is deemed to be an “S corporation” for state tax purposes pursuant to Chapter 35 of the Statutes of 2002. This bill would also prohibit utilization of any net operating loss carryover against net built-in gain recognized by the corporation, as provided.

*This bill would take effect immediately as a tax levy.*

Vote: majority. Appropriation: no. Fiscal committee: yes.  
State-mandated local program: no.

*The people of the State of California do enact as follows:*

- 1 SECTION 1. Section 23803 of the Revenue and Taxation
- 2 Code is amended to read:
- 3 23803. (a) (1) With respect to credits that are otherwise
- 4 allowed to reduce the taxes imposed under this part:
- 5 (A) The amount of any credit to be claimed is limited to
- 6 one-third of the amount otherwise allowable.
- 7 (B) (i) Any unused portion of the credit allowable under
- 8 subparagraph (A) (one-third of the total credit) is allowed to be
- 9 carried forward and may not be subject to additional reductions
- 10 under subparagraph (A) in later years.
- 11 (ii) No carryforward is allowed for the portion of the credit
- 12 denied under subparagraph (A) (two-thirds of the total credit).
- 13 (C) Credits carried forward from taxable years beginning prior
- 14 to the first taxable year in which the corporation is treated as an “S
- 15 corporation” under this part, shall be reduced in accordance with
- 16 subparagraph (A) for that first taxable year and may not be subject
- 17 to additional reductions under subparagraph (A) in later years.
- 18 (D) (i) Notwithstanding any other provision of law,
- 19 subparagraph (A) of paragraph (1) of this subdivision does not
- 20 apply to credits generated by a corporation that is described in



1 clause (ii) of this subparagraph and carried forward from the last  
2 taxable year beginning before January 1, 2002, in which that  
3 corporation was treated as a “C corporation,” to the first taxable  
4 year beginning on or after January 1, 2003, in which the  
5 corporation is treated as an “S corporation” pursuant to the  
6 enactment of Chapter 35 of the Statutes of 2002. The credits that  
7 are carried forward from the last taxable year of the “C  
8 corporation” beginning before January 1, 2002, may not be  
9 reduced in later years and may be utilized to offset the tax imposed  
10 under either Section 23151 or Section 23501.

11 (ii) This subparagraph applies to a corporation that, for its last  
12 taxable year beginning before January 1, 2002, was an “S  
13 corporation” for federal income tax purposes and a “C  
14 corporation” for purposes of Part 10 (commencing with Section  
15 17001), Part 10.2 (commencing with Section 18401), and this part,  
16 and, as a result of the enactment of Chapter 35 of the Statutes of  
17 2002, is an “S corporation” for the corporation’s taxable year  
18 beginning on or after January 1, 2003.

19 (E) Paragraphs (2) and (3) of subdivision (f) of Section 23802  
20 apply prior to the reduction required by subparagraph (A).

21 (F) No portion of any credit to which this paragraph applies  
22 may be passed through to the shareholders of the “S corporation.”

23 (G) This paragraph does not affect the amount of any credit  
24 computed under Part 10 (commencing with Section 17001) for  
25 pass-through to shareholders in accordance with the provisions of  
26 Section 1366 of the Internal Revenue Code.

27 (2) With respect to credits that are allowed to the “S  
28 corporation” only because it is treated in the same manner as an  
29 individual, the provisions of Section 1366(a) of the Internal  
30 Revenue Code shall be modified to provide that the shareholder’s  
31 pro rata share of the corporation’s credits shall include the credit  
32 for political contributions allowed under Section 17053.14.

33 (b) Section 1366(f) of the Internal Revenue Code, relating to  
34 special rules, is modified as follows:

35 (1) The amount of tax used to compute the reduction allowed  
36 by Section 1366(f)(2) is the amount of tax imposed on built-in  
37 gains under this part.

38 (2) The amount of tax used to compute the reduction allowed  
39 by Section 1366(f)(3) is the amount of tax imposed on excess net  
40 passive income under this part.

1 (c) The amendments to this section made by this act shall apply  
2 to taxable years beginning on or after January 1, 2003.

3 SEC. 2. Section 23806 of the Revenue and Taxation Code is  
4 amended to read:

5 23806. (a) Section 1371(a) of the Internal Revenue Code,  
6 relating to application of Subchapter C rules, is modified to  
7 provide that, notwithstanding subdivisions (a) and (e) of Sections  
8 17024.5 and 23051.5, any election by an “S corporation” or its  
9 shareholders under Section 338 of the Internal Revenue Code,  
10 relating to certain stock purchases treated as asset acquisitions, for  
11 federal purposes is treated as an election for purposes of this part  
12 and a separate election under paragraph (3) of subdivision (e) of  
13 Section 17024.5 or 23051.5 is not allowed.

14 (b) No election under Section 338 of the Internal Revenue  
15 Code, relating to certain stock purchases treated as asset  
16 acquisitions, is allowed for state tax purposes unless the “S  
17 corporation” or its shareholders made a valid election for federal  
18 income tax purposes under Section 338 of the Internal Revenue  
19 Code.

20 (c) (1) Section 1371(b)(1) of the Internal Revenue Code is  
21 modified to provide that any corporation described in paragraph  
22 (2) is allowed to carry forward a net operating loss of the  
23 corporation as a “C corporation,” as allowed under this part, from  
24 the last taxable year beginning before January 1, 2002, to the first  
25 taxable year beginning on or after January 1, 2004, in which the  
26 corporation is treated as an “S corporation” pursuant to the  
27 enactment of Chapter 35 of the Statutes of 2002.

28 (2) This subdivision applies to a corporation that, for its last  
29 taxable year beginning before January 1, 2002, was an “S  
30 corporation” for federal income tax purposes and a “C  
31 corporation” for purposes of Part 10 (commencing with Section  
32 17001), Part 10.2 (commencing with Section 18401), and this part,  
33 and, as a result of the enactment of Chapter 35 of the Statutes of  
34 2002, is an “S corporation” for the corporation’s taxable year  
35 beginning on or after January 1, 2004.

36 (d) Section 1371 (d) of the Internal Revenue Code does not  
37 apply.

38 (e) The amendments to this section made by this act shall apply  
39 to taxable years beginning on or after January 1, 2004.

1 SEC. 3. Section 23809 of the Revenue and Taxation Code is  
2 amended to read:

3 23809. There is hereby imposed a tax on built-in gains  
4 attributable to California sources, determined in accordance with  
5 the provisions of Section 1374 of the Internal Revenue Code,  
6 relating to tax imposed on certain built-in gains, as modified by  
7 this section.

8 (a) (1) The rate of tax specified in Section 1374(b)(1) of the  
9 Internal Revenue Code is equal to the rate of tax imposed under  
10 Section 23151 in lieu of the rate of tax specified in Section 11(b)  
11 of the Internal Revenue Code.

12 (2) In the case of an “S corporation” which is also a financial  
13 corporation, the rate of tax specified in paragraph (1) shall be  
14 increased by the excess of the rate imposed under Section 23183  
15 over the rate imposed under Section 23151.

16 (b) Section 1374(b)(2) of the Internal Revenue Code, relating  
17 to net operating losses, is modified to provide that any net  
18 operating loss allowed or allowable under subdivision (c) of  
19 Section 23806 is not allowed as a deduction against net recognized  
20 built-in gain.

21 (c) Section 1374(b)(3) of the Internal Revenue Code, relating  
22 to credits, shall be modified to provide that the tax imposed under  
23 subdivision (a) shall not be reduced by any credits allowed under  
24 this part.

25 (d) Section 1374(b)(4) of the Internal Revenue Code, relating  
26 to coordination with Section 1201(a), does not apply.

27 (e) In the case of a corporation that is subject to the provisions  
28 of former Section 1374 of the Internal Revenue Code (prior to  
29 amendment by Public Law 99-514), the provisions of that section  
30 are modified to provide that:

31 (1) The tax specified in Section 1374(b)(1) of the Internal  
32 Revenue Code is equal to the rate of tax imposed under Section  
33 23151 in lieu of the rate of tax specified in Section 11(b) of the  
34 Internal Revenue Code.

35 (2) In the case of an “S corporation” that is also a financial  
36 corporation, the rate of tax specified in paragraph (1) shall be  
37 increased by the excess of the rate imposed under Section 23183  
38 over the rate imposed under Section 23151.

39 (f) The amendments to this section made by this act shall apply  
40 to taxable years beginning on or after January 1, 2004.

1     *SEC. 4. This act provides for a tax levy within the meaning of*  
2     *Article IV of the Constitution and shall go into immediate effect.*

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